SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

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# No. 93

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HERCULES GASOLINE COMPANY, INC.,
*Petitioner,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent*

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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## REPLY BRIEF FOR PETITIONER ON MERITS

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December 5, 1945.

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## REPLY BRIEF FOR PETITIONER ON MERITS

### I

### The Steel Mills and Crane-Johnson Decisions Have Been Overruled by Congress

It is submitted, in reply to Respondent's brief (p. 18), that the Government cannot draw any aid or comfort from the decisions in *Helvering* v. *Northwest Steel Rolling Mills*, 311 U. S. 46, and *Crane-Johnson Co.* v. *Helvering*, 311 U. S. 54 (as well as the Circuit Court holdings which followed them), because by Sec. 501 of the Revenue Act of 1942[1]

[1] 26 U. S. C. A. Int. Rev. Acts, 1944 Supp., page 257; 56 Stat. 798; *U. S.* v. *Byron Rush & Door Co.*, 150 F. (2d) 44.

Congress reaffirmed its purpose and intention and, in effect, overruled these cases by giving retroactive credit to deficit corporations.[2] Counsel is informed that pursuant to this enactment, the Government has refunded the amounts of the judgments in these cases with 6% interest thereon.

It is settled that subsequent legislation may be considered to assist in the interpretation of prior legislation upon the same subject,[3] and it is hard to see why Congress would not want to tax corporations forbidden by law to declare dividends and want to tax those forbidden by contract to do so. The theory of the undistributed profits tax was that corporations able to declare dividends should have an option to do so and avoid the tax, but that corporations having no option were not to be taxed.

When the cases cited by the Respondent are analyzed, it will be found that they are insubstantially based. Take, for instance, the *Elliott Addressing Machine Co.* v. *Commissioner* (131 F. (2d) 700). It will be discovered that there was no stipulation prohibiting dividends. It is like the *Monarch* case (137 F. (2d) 588) in that there was no promise not to pay dividends. Therefore, neither this 1st nor 2nd Circuit Court case is pertinent to the present question.

The deficit cases cited from the 6th Circuit (*Warren, Metal Specialty, Bishop & Babcock*) are bottomed upon the *Steel Mills* case which, as we have pointed out above, has been retroactively overruled by the legislature.

On pages 11, 12 and 13 of the Respondent's brief the statement is made, followed by labored argument, that the basis of the tax was that portion of the undistributed net income

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[2] See Vol. 1, p. 1022, Hearings Before the Committee on Finance, United States Senate, on Rev. Act of 1942; Senate Finance Committee Report (No. 1631), p. 245 thereof.

[3] *Great Northern Ry. Co.* v. *U. S.*, 315 U. S. 262, 267.

of the corporation which was in excess of specified percentages of the adjusted net income. We surmise from the argument on this point that Respondent now wants to limit the credit to the sum of $64,700 due by the corporation to its preferred stockholders. Although this section is not too clear, we think Sec. 26 (c) (1) gives the basis of credit, not the basis of tax. When a contract prohibits the payment of any dividend whatsoever, as in the present case, credit "shall" be allowed against all undistributed net income.

Our reading of Sec. 26 (c) (1) and (2) is that both subsections require a "written contract executed by the corporation," but that sub-section (1) applies to prohibitions against distributions and sub-section (2) applies to requirements as to dispositions in discharge of debts. Naturally, either contract would make the corporation unable to distribute surplus profits.

## II

## We Rely upon the Stock Certificates, Not the Charter, for the Contract

Respondent argues also that transferor's charter was not "executed" by the corporation and that the stock certificates did not "expressly" prohibit the payment of dividends (Br., p. 33, et seq.). As to these strained arguments, now made for the first time, we believe we have answered these points in our original brief. Of course, we are not relying upon a charter as a contract executed by the corporation and would make note that the charter in the *Steel Mills* case did not contain any restriction. We do rely upon the written, executed stock certificates as a contract executed by the corporation which carried by specific reference the dividend restriction. In Louisiana, where this contract was made, the highest court has held that the maxim of the law in interpreting contracts is that words referred to

are considered as incorporated in the instrument.[4] In support of these points in the brief, respondent cites no binding authority or governing principle.

Under our civil law, agreements legally entered into have the effect of laws on those who have formed them. They cannot be revoked unless by mutual consent of the parties or for causes acknowledged by law. They must be performed with good faith (La. Revised Civil Code, 1901; 1945-6).

When this particular case is stripped of its legalistic clothing down to its bare issue, it is plain that the Commissioner is attempting to force the officers of the corporation, against their will, to violate their contract not to pay dividends or suffer a heavy penalty for not doing so. His forcible intrusion manifestly impairs the rights of property and invades the rights and powers of management of the corporation by its officers and stockholders. What respondent wants is not construction, but enlargement.

## III

## Doesn't the Respondent Want This Court to Supply Omissions, or to Enlarge, the Statute?

Respondent suggests that Congress did not intend to include this *kind* of contract in the credit provisions. Congress did not define or limit the written contract. The Commissioner by his ipse dixit ruled that the stock certificates do not constitute a written contract executed by the corporation within the meaning of this law. What reason does he have for separating contracts into different *kinds?* What proof has he that Congress was not intending to include all contracts? On what ground can he create this exception or demand this exclusion? What principle or reason supports

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[4] *Weinberger* v. *Insurance Company*, 41 La. Annual 31.

the distinction? Are these contracts concerning the sale of corporate stocks and securities of so little estimation in the United States that they must be excluded from the protection of words which, in their natural import, include them? Are the ordinary rules of construction to be disregarded in order to leave such agreements exposed to alteration or to overriding by the Commissioner? Is his summary ruling binding on the taxpayer? He has no judicial functions!

This corporation was bound by a bona fide contract, containing all elements of mutuality and validity, not to declare dividends. This contract was entered into in 1933. It was confirmed by amendment to the charter in 1935. It was fully performed in 1939. It was only in 1942 that the Commissioner construed the agreement as not constituting a written contract.

In conclusion, and referring again to the reaction of Congress to the cases involving deficit corporations, may we reemphasize the proposition:

Why should Congress not want to tax corporations forbidden by law to declare dividends and to tax those forbidden by contract to do so?

Respectfully submitted,

MELVIN F. JOHNSON,
*Counselor for Petitioner.*

December 5, 1945.